



## You Are What They Eat: A Guide To Winning the ‘Nutraceuticals’ Market

Facing an aging population and increasing rates of chronic diseases such as hypertension and diabetes, healthcare in North America and Europe is shifting its emphasis from intervention to prevention. A growing number of consumers are taking notice; their changing behavior will have profound implications for both pharmaceutical and food companies. For many Americans and Europeans, the prescription pad no longer casts the spell of restorative promise it once did, and they are seeking proactive health solutions to avoid negative pharmaceutical interventions. Wellness initiatives are also empowering consumers to seek healthier food options, and view nutrition as key to managing their health.

One battlefield for these new customers is a range of products that have come to be known as “nutraceuticals.” Broadly defined, nutraceuticals are foods or nutritional supplements that promise medical or health benefits; they exist in the middle of the food-drug spectrum between health foods on one end and traditional prescription drugs on the other, and encompass functional foods, nutritional supplements and medical foods (see Figure 1). Traditional food and beverage companies are attracted to nutraceuticals’ comparatively high margins. Pharmaceutical companies are enticed by the significantly lower R&D and regulatory burdens of nutraceuticals compared to their prescription and over-the-counter products. Both see an opportunity to compete.

The result is a large, fast-growing product category that is already challenging the traditional boundaries of food and pharma. Unlikely partnerships are being formed, and significant investment is being made by food, pharma and existing players to capitalize on this rapidly growing opportunity. Winning the nutraceuticals market will require food and pharma companies to adopt strategies that build on their relevant expertise while enhancing capabilities outside of their traditional comfort zone. Food companies will need to exploit their merchandising experience while developing scientific and regulatory expertise. Pharmaceutical companies will need to establish brand presence and credibility while leveraging their scientific and regulatory advantages. Broadly put, the winners in the food versus pharma battle for nutraceutical market share will be the companies that can most quickly and effectively harness the core strengths of both industries; these hybrid products, unsurprisingly, require the best of both worlds.

### Food and Pharma Seek New Elixirs








Over the past five years, the U.S. nutraceutical market has experienced robust growth fueled by high consumer demand, product innovation and relatively low regulatory hurdles. Products as diverse as nutritional shakes for Alzheimer’s patients to vitamin drink mixes for kids have begun to fill shelves at specialty shops, drug stores and even supermarkets. Currently worth

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**Figure 1**  
Traditional Food and Beverage Health Spectrum

	Food-like				Drug-like		
Sub-segment	Everyday Food	Organic Food	Better-for-you Food	Functional Foods	Nutritional Supplements	Medical Foods	OTC/ Prescription Medicines
Example							
Representative Companies	<ul style="list-style-type: none"> <li>Campbell's</li> <li>DiGiorno</li> <li>Kraft</li> </ul>	<ul style="list-style-type: none"> <li>Organic Valley</li> <li>Applegate Farms</li> <li>Simply Organic</li> </ul>	<ul style="list-style-type: none"> <li>Silk Soy Milk (Dean Foods)</li> <li>Chaboni</li> <li>Udi's Gluten Free Foods</li> </ul>	<ul style="list-style-type: none"> <li>Activia (Dannon)</li> <li>Yo-Plus (Yoplait)</li> </ul>	<ul style="list-style-type: none"> <li>Nutrite</li> <li>NBTY</li> <li>Pharmavite</li> </ul>	<ul style="list-style-type: none"> <li>Nestlé HealthCare Nutrition</li> <li>Accera</li> <li>Medrition</li> </ul>	<ul style="list-style-type: none"> <li>Pfizer</li> <li>Novartis</li> <li>Merck &amp; Co.</li> </ul>
Regulation	← Less						More →
Functional Benefits/Claim	← Less						More →
Science-based	← Less						More →
Taste-driven	← More						Less →
Medical Supervision	← Less						More →

Source: L.E.K. Consulting

around \$75 billion, the market grew at around 7% annually between 2007-2012, and is expected to grow at roughly 8% a year through 2018, with most of that growth in the U.S., Europe and Japan.<sup>1</sup>

Those growth results would make any food or pharma executive blush; most of their segments will likely struggle to push the needle beyond a nominal growth rate of around 3-4% per year in the immediate future. For major food and beverage companies, rising commodity prices have increased costs, while the growing acceptance among consumers of 'private labels' (such as generic supermarket brands) has eroded market power and increased the pressure on prices—a recipe for compressed margins. For pharmaceuticals, the ongoing expiration of patents for several blockbuster drugs is leaving gaping holes in their

profit and loss statements, while escalating R&D costs, significant development risk, and a string of high profile failures has left a dearth of new blockbusters in the pipeline to fill the gap.

Given the top line and margin pressures in the food and pharma sectors, major players in each camp are eyeing the nutraceutical segment as a potential new engine for growth. Food companies see nutraceuticals as opportunities to grow revenue, as the products spread their reach into new aisles of stores, and expand margins given nutraceuticals' higher price points (without much added unit cost) compared to traditional food and beverage products. Pharma companies view the nutraceutical segment as an opportunity to grow their product base by leveraging scientific credibility while avoiding the costly pre-approval process of the Food and Drug Administration (FDA) and other regulatory bodies in Europe and Japan.

<sup>1</sup> Source: Global Industry Analysts, British Food Journal, PwC, Transparency Market Research, L.E.K. analysis.




















In the past two years, both types of companies have started to stake out positions. The opening moves have taken the form of M&A activity, as Big Food and Big Pharma attempt to purchase an entry ticket to the market by acquiring pure-play nutraceutical companies. On the food side, large players such as Nestlé and Danone have been particularly active, as evidenced by Nestlé's recent \$11.8 billion acquisition of Pfizer Infant Nutrition, which makes breast milk replacement formula, and its 2013 purchase of medical-food maker Pamlab. Danone's opening gambits included the 2011 acquisitions of Britain-based Complan Foods, makers of powdered energy drinks and meal replacements, and Medical Nutrition, which produces medical food to treat malnutrition.

Pharma companies have also made significant acquisitions, including Reckitt Benckiser's \$1.4 billion purchase of Schiff Nutrition's vitamin supplements, drink mix and nutrition bar business, and Pfizer's 2012 bid for the Emergen-C vitamin supplement brand. Even personal care products companies are beginning to invest significantly, further validating the

segment's potential. In March of 2012, Proctor and Gamble bought New Chapter's vitamins and probiotic business, and in August that same year Church and Dwight acquired New Jersey-based Avid Health for its gummy vitamin products.

The game is afoot. While we are still in the early innings, we believe consolidation will continue and perhaps intensify given that the fundamental growth drivers of the nutraceutical segment will persist, as will the growth challenges facing both food and pharma companies. The most promising pure-plays will continue to be attractive acquisition targets for bigger players. Forecasting a precise pattern of consolidation is an inexact science, but we can make an educated guess by looking at major food and pharma companies' brand portfolios, and identifying where nutraceuticals might fill gaps for certain conditions and health problems. As Figure 2 and Figure 3 indicate, there are still significant gaps in the condition-specific offerings of both food companies and pharma companies. It's highly likely that ongoing consolidation will be targeted at filling in these portfolios.








































**Figure 2**  
Food Company Brands

Parent Companies	General Brands	Condition-Specific Brands									
		General Health	Immunity	Children's Health	Sports/ Energy	Brain/ Mental Acuity	Cardio/ Heart Health	Joint/ Bone Health	GI Health	Weight Loss/ Metabolic Disease/ Diabetes	Other
											
											
											
											

Source: L.E.K. Consulting

 Functional Food     Medical Food

**Figure 3**  
Pharma Company Brands

Parent Companies	General Brands	Condition-Specific Brands									
		General Health	Immunity	Children's Health	Sports/ Energy	Brain/ Mental Acuity	Cardio/ Heart Health	Joint/ Bone Health	GI Health	Weight Loss/ Metabolic Disease/ Diabetes	Other
											
											
											
											
											
											
											

Source: L.E.K. Consulting

Functional Food      Supplement      Medical Food

## How To Win

Will food or pharma “win” the nutraceutical segment? Food companies have an advantage in functional foods given their marketing and brand expertise, established distribution networks and their ability to compete on taste. No industry is better at identifying, stimulating and feeding consumer demand than Big Food. Yet they have little regulatory experience or expertise with scientifically driven products. In contrast, pharma companies may be better positioned in some nutritional supplement categories due to their scientific resources, manufacturing capabilities and regulatory expertise. In a race to innovate new, scientifically supported nutraceuticals, Big Pharma clearly has a head start.

Both food and pharma, then, will face their own challenges, and exploit their own natural advantages, as they chase the nutraceutical segment. As they move forward, we have identi-

fied four universal strategic questions that companies in both industries must answer if they wish to succeed.

**1. Where do you play?** Which disease areas have dietary factors that contribute to disease risk and progression, and which of these are underserved by current medical approaches?

**2. What is your business model?** Who are the stakeholders who are likely to drive adoption and use of the nutraceuticals (consumers?, physicians?, others?)? What model is best able to activate that adoption?

**3. How do you promote?** How can you drive adoption by developing scientific evidence, leveraging communication ecosystems (patient message boards, social media, etc.), and aligning financial incentives?

#### 4. What capability gaps do you have? How do you acquire the capabilities to succeed?

In Figure 4, we summarize the important implications for food and pharma companies, as well as endemic nutraceutical companies and financial sponsors (investors in nutraceutical companies) as they attempt to answer these questions.

It would be understandable if pharmaceutical and food and beverage executives felt macro trends were against them; in their core segments, they are. But nutraceuticals is a booming new market. Successful entrance into this market will not be an entirely comfortable process for either food or pharma; each industry will need to learn the strengths of the other. The company that can do that quickly and most effectively will win.

Figure 4

Key Implications	
Food	<ul style="list-style-type: none"> <li>• Must form relationships with new channel partners               <ul style="list-style-type: none"> <li>- Medical practitioner</li> <li>- Direct-to-consumer</li> <li>- Health/natural stores</li> </ul> </li> <li>• Must establish scientific credibility through product benefit testing and enhanced R&amp;D</li> </ul>
Pharma	<ul style="list-style-type: none"> <li>• Science alone is not sufficient to win in nutraceutical categories               <ul style="list-style-type: none"> <li>- For products closer to foods (shakes, powders, etc.), must develop products that can compete on taste</li> <li>- Must expand presence in consumer food outlets</li> <li>- Re-engineer marketing and branding to be more consumer-facing</li> </ul> </li> </ul>
Endemic Nutraceutical	<ul style="list-style-type: none"> <li>• Opportunities to sell to food or pharma will likely continue</li> <li>• New product innovations are key (e.g. flavors, benefits, therapeutic areas)</li> </ul>
Financial Sponsor	<ul style="list-style-type: none"> <li>• Multiple exit options for portfolio holdings</li> <li>• Entering nutraceutical segments may be risky – opportunities for large exits or sudden competition from new conglomerate entrant</li> </ul>

## INSIGHTS@WORK™

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